

REPORT OF EXAMINATION
OF THE
FIREMAN'S FUND INSURANCE COMPANY
AS OF
DECEMBER 31, 2003

Participating States
and Zones:

California
New Jersey, Zone I – Northeastern

Filed June 24, 2005

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San Francisco, California
April 1, 2005

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable John Morrison
Secretary, Zone IV-Western
Commissioner of Insurance and Securities
Montana Department of Insurance
Helena, Montana

Honorable Julie M. Bowler
Secretary, Zone I-Northeastern
Commissioner of Insurance
Massachusetts Department of Insurance
Boston, Massachusetts

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman and Commissioners:

Pursuant to your instructions, an examination was made of the

FIREMAN'S FUND INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 777 San Marin Drive, Novato, California 94998.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 1999. This examination covers the period from January 1, 2000 through December 31, 2003. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. An examiner from the State of New Jersey, representing Zone I, participated in this examination. The examination included a review of the Company's practices and procedures, an examination of

management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2003, as deemed necessary under the circumstances.

The Company is the lead insurer in an intercompany reinsurance agreement with nine of its affiliates (hereinafter also referred to as the “participants”). Under the terms of this agreement, the participants cede, and the Company assumes, 100% of the participants’ business generated from underwriting operations. The cessions from the participants are combined with the Company’s business, resulting in the pooled balance to be allocated to the Company and each participant; consequently, in order to examine the Company’s assets and liabilities that resulted from pooling, it was necessary to review this pooled balance.

The following affiliates participated in the intercompany reinsurance agreement at December 31, 2003:

Company

The American Insurance Company (Nebraska)
National Surety Corporation (Illinois)
American Automobile Insurance Company (Missouri)
Associated Indemnity Corporation (California)
Fireman’s Fund Insurance Company of Ohio (Ohio)
Interstate Fire & Casualty Company (Illinois)
Chicago Insurance Company (Illinois)
Interstate Indemnity Company (Illinois)
Fireman’s Fund Insurance Company of Wisconsin (Wisconsin)

All of the above companies were examined concurrently by their respective States of domicile.

In addition to those items specifically commented upon in this report, other phases of the Company’s operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers’, employees’ and agents’ welfare and pension plans; growth of company; business in force by states; loss experience; and sales and advertising.

EVENTS OF SEPTEMBER 11, 2001

Fireman's Fund Insurance Group reported \$71 million in gross property and casualty losses through December 31, 2003 from the terrorist attacks on the World Trade Center in New York on September 11, 2001. Of this amount, a total of \$26.95 million was ceded to third party reinsurers. The Company's pooled share of incurred losses totaled \$33.1 million.

The Company evaluated its non-insurance losses with respect to the terrorist attacks on the World Trade Center and determined that nearly all such losses were fully insured through third-party insurers.

COMPANY HISTORY

On January 2, 1991, Allianz of America, Inc. (AZOA), a U.S. subsidiary of Allianz Aktiengesellschaft (Allianz AG), a corporation organized in Munich, Germany, purchased 100% of the capital stock of Fireman's Fund Insurance Company.

Effective November 1, 1997, the Company and its subsidiaries became a wholly-owned subsidiary of Allianz Insurance Company, a subsidiary of AZOA. Allianz Insurance Company changed its name to Allianz Global Risks US Insurance Company (AGR) in 2003.

Capitalization

The Company is authorized to issue 1 billion shares of Class A voting common stock with a par value of \$15 per share. As of December 31, 2003, there were 280 million shares outstanding. Capital contributions made since the prior examination date of December 31, 1999 are as follows:

On June 28, 2001, the Company received a cash capital contribution from its direct parent, AGR, in the amount of \$166 million.

Effective September 28, 2001, the California Department of Insurance (CDI) granted AGR approval under a permitted accounting practice, to record a \$1 billion surplus contribution to the Company. In a series of same-day transactions, the Company was assigned all rights to and interest in six affiliate promissory notes with an aggregate principal balance of \$1 billion and a maturity date of September 28, 2006. For additional information regarding this surplus contribution, refer to the “Management and Control - Related Party Transactions” section of this report.

On June 28, 2002, the Company received from AGR, a capital contribution of 5,339,806 shares of Class A Series A Preferred Stocks of Allianz Life Insurance Company of North America, an affiliate domiciled in Minnesota. The preferred shares were issued at \$35.02 per share for a total of \$187,000,006.

On September 30, 2002, the Company entered into a loss portfolio transfer agreement with Allianz AG. Under the terms of this agreement, Allianz AG assumed losses associated with asbestos and environmental claims for a maximum of \$2,158,500,000 for accident years 1987 and prior. In lieu of having the Company pay the full premium of \$1,276,000,000, Allianz AG dismissed \$1.1 billion of premium payment by assigning the premium to AZOA, which, in turn, assigned the premium to AGR. AGR then assigned the premium payment back to the Company as a capital contribution. Therefore, no cash was actually exchanged for the \$1.1 billion premium payment. A trust account was established by the Company for the remaining \$176 million.

On December 30, 2002, the Company received a cash capital contribution from AGR in the amount of \$500 million.

Restructuring Program

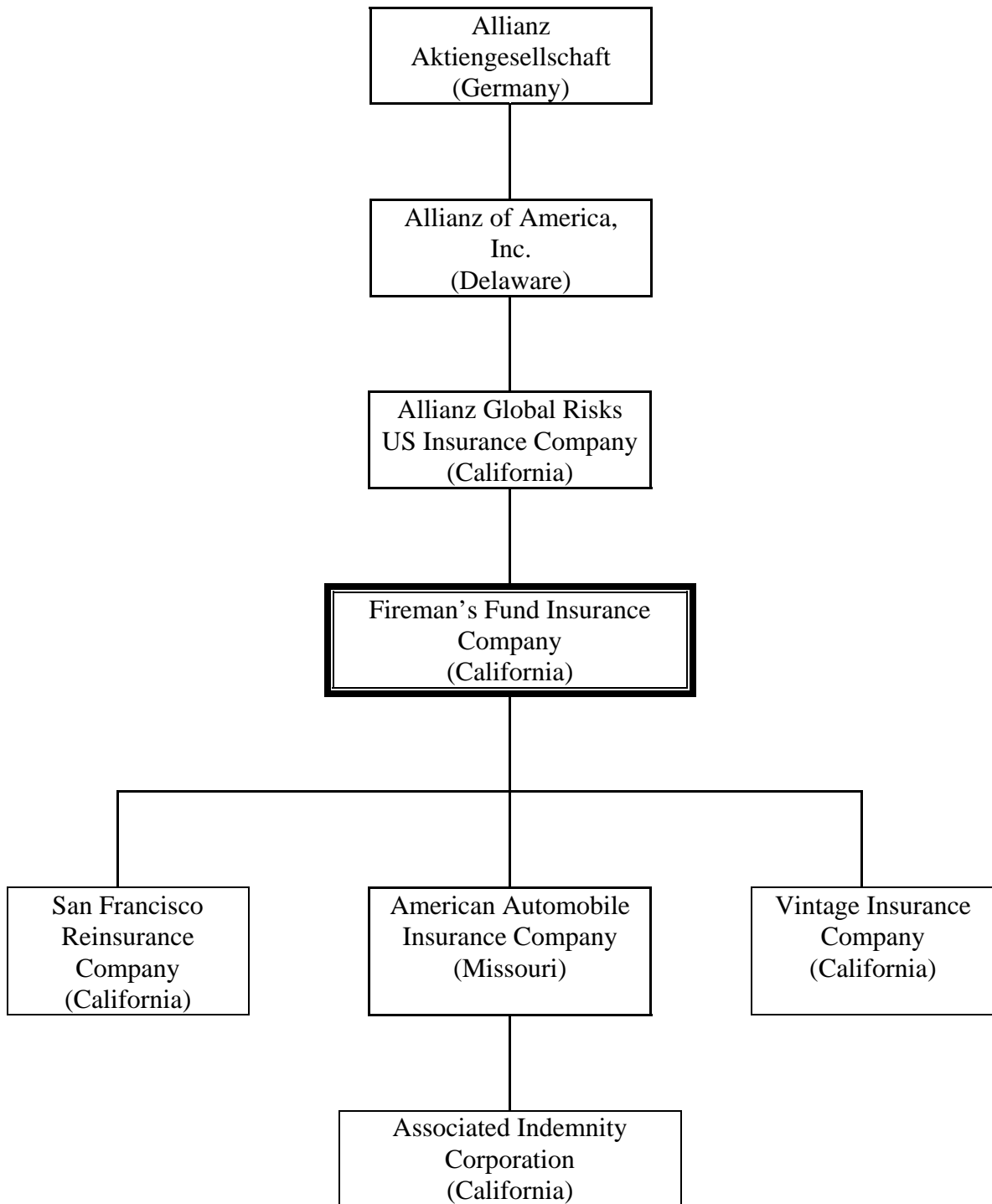
In April 2001, Fireman’s Fund Insurance Group (Group) underwent significant restructuring. As a result of the restructuring program, the Group discontinued writing new business in national accounts, Firemen’s Fund direct, diversified risk, and surety segments. Additionally, the restructuring resulted in a change from two divisions – commercial and personal - to five business units.

Dividends Paid to Parent

During 2000, the Company paid ordinary dividends to AGR totaling \$200 million. In November, 2004 the CDI approved the Company's request for a non-cash extraordinary dividend to AGR totaling \$495 million.

MANAGEMENT AND CONTROL

The Company is a member of an insurance holding company system. Allianz Aktiengesellschaft (Allianz AG), a corporation organized in Munich, Germany, is the ultimate controlling entity. The chart on the following page depicts the interrelationship of the Company and its California subsidiaries within the holding company system (all ownership is 100%):



The board of directors, comprised of nine members, manages the business and affairs of the Company. Following are members of the board of directors and principal officers of the Company serving at December 31, 2003:

Directors

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Jan R. Carendi Munchen, Germany	Member of the Board of Management Allianz Aktiengesellschaft (Germany)
Peter Huehne (a) Tiburon, California	Executive Vice President and Chief Financial Officer Fireman's Fund Insurance Company
Jeffrey H. Post (b) Novato, California	President and Chief Executive Officer Fireman's Fund Insurance Company
Joseph J. Beneducci Santa Rosa, California	Executive Vice President Fireman's Fund Insurance Company
Helmut Perlet Pahl/Aidenreid, Germany	Member of the Board of Management Allianz Aktiengesellschaft (Germany)
Charles M. Kavitsky Edina, Minnesota	President Allianz Life Insurance Company of North America
H. David Lundgren Tiburon, California	Executive Vice President Fireman's Fund Insurance Company
Peter W. Presperin (c) Novato, California	Executive Vice President Fireman's Fund Insurance Company
Paul M. Saffert Novato, California	Chief Financial Officer Allianz of America Corporation

(a) Appointed CFO of Allianz of America (AZOA) effective January 1, 2004.

(b) Resigned in May, 2004 and was replaced by Charles Kavitsky, who previously held the position as President of Allianz Life Insurance Company.

(c) Appointed CFO of FFIC effective January 1, 2004. Prior to this appointment, Mr. Presperin was the Director of Discontinued Operations at FFIC. He resigned as CFO of FFIC in October 2004 and was replaced by Jill Patterson.

Principal Officers

<u>Name</u>	<u>Title</u>
Jan R. Carendi	Chairman of the Board
Jeffrey H. Post (a)	President and Chief Executive Officer
Joseph J. Beneducci	Executive Vice President
Thomas E. Geissler	Executive Vice President
Peter Huehne (b)	Executive Vice President and Chief Financial Officer
H. David Lundgren	Executive Vice President
Peter W. Presperin (c)	Executive Vice President
Susan J. Albrecht	Senior Vice President
David L. Conway	Senior Vice President
Earl C. Davis	Senior Vice President
Joseph F. Dillon, Jr.	Senior Vice President
Bruce F. Friedberg	Senior Vice President
Lawrence T. Hannon, Jr.	Senior Vice President
Janet S. Kloenhamer	Senior Vice President, General Counsel and Corporate Secretary
Deborah J. Knox	Senior Vice President
Peter A. Lefkin	Senior Vice President
Frederick E. Matteson	Senior Vice President
Arthur E. Moossmann, Jr.	Senior Vice President
Jill Paterson	Senior Vice President and Controller
Steven B. Resnick	Senior Vice President
David C. Sargent	Senior Vice President
Daniel J. Sevilla, Jr.	Senior Vice President
Alastair C. Shore	Senior Vice President
Cynthia A. Tidwell	Senior Vice President
Linda E. Wright	Senior Vice President and Treasurer

- (a) Resigned in May, 2004 and was replaced by Charles Kavitsky, who previously held the position as President of Allianz Life Insurance Company.
- (b) Appointed CFO of Allianz of America (AZOA) effective January 1, 2004.
- (c) Appointed CFO of FFIC effective January 1, 2004. Prior to this appointment, Mr. Presperin was the Director of Discontinued Operations at FFIC. He resigned as CFO of FFIC in October 2004 and was replaced by Jill Patterson.

Management Arrangements

Tax Reimbursement Agreement: Effective December 17, 1999, the Company entered into a Tax Reimbursement Agreement for the purpose of clarifying an agreement that was in effect since 1991. The Tax Reimbursement Agreement was between Allianz of America, Inc. (AZOA) and the

Company and its subsidiaries. Under this agreement, the tax liability of the Company and its subsidiaries will be computed as if each member filed a separate stand-alone return. AZOA is the party primarily responsible for filing and making all tax payments on behalf of the Company and its subsidiaries.

Additionally, the Company had forty-six intercompany management and service agreements with its affiliated companies at December 31, 2003. The principal agreements were reviewed and found to be materially in compliance with the California Insurance Code (CIC) and filed with the California Department of Insurance (CDI) as required.

Related Party Transactions:

- (1) On July 25, 2000, the Company made a paid-in surplus distribution to its parent, Allianz Global Risks US Insurance Company (AGR), totaling \$250 million.
- (2) On January 26, 2001, the Company loaned AZOA \$180 million. The loan was secured by a pledge agreement whereby AZOA pledged the common stock of Allianz Life Insurance Company of North America. The pledge agreement requires the stock to have a fair market value of 120% of the principal amount of the note. This amounted to 5,342,018 shares as of the date of the loan.
- (3) Effective September 28, 2001, the CDI granted AGR approval under a permitted accounting practice to record a \$1 billion surplus contribution to the Company. In a series of same-day transactions, the Company was assigned all rights to and interest in six affiliate promissory notes with an aggregate principal balance of \$1 billion and a maturity date of September 28, 2006. One of the conditions of the CDI's approval is that the Company's ultimate parent, Allianz Aktiengesellschaft (Allianz AG), guaranty the notes by pledging securities equal to 120% of the principal of each note. Share pledge agreements were executed for each of the six promissory notes; however, the agreements did not contain a clause requiring the market value of the pledged securities be equal to 120% of the principal amount of the note. The market value of the pledged securities at

December 31, 2003 was \$99.7 million less than the required value based on 120% of market. At March 31, 2004 the collateral deficiency increased to \$153.5 million. It is recommended these agreements be amended to require the market value of pledged securities be at least 120% of the principal balance of the note.

In September and October of 2002, due to changes in the German tax structure, the pledged securities were transferred to various fully-owned and controlled subsidiaries of Allianz AG. These subsidiaries, referred to as “Vermögensverwaltungsgesellschaften,” assumed the obligations of Allianz AG under the pledge agreements. The obligations were transferred back to Allianz AG in 2003 and new pledge agreements were executed between the Company and Allianz AG. Two issues relating to the transfer of obligations under the pledge agreements were noted:

- a) The initial share pledge agreements executed in 2001 did not contain a provision that allowed Allianz AG to transfer its obligations as the pledgor to any of its affiliates. Consequently, Allianz AG did not comply with the terms of the share pledge agreements. This provision was added to the pledge agreements executed in 2003. It is recommended the Company implement controls to ensure that legally binding agreements between affiliates are enforced.
- b) The Company did not notify the CDI of the transfer of obligations in 2002, which is a violation of CIC Section 1215.5(b). As one of the conditions of the CDI’s approval of the \$1 billion surplus contribution is Allianz AG’s commitment to repay the notes, the Company is required to notify the CDI at least 30 days prior to entering into to a material transaction that relates to the agreements.

In December, 2002, the Company entered into a Securities and Securities Account Pledge Agreement with AZ-Arges Vermögensverwaltungsgesellschaft, a fully-owned and controlled subsidiary of Allianz AG. The purpose of this agreement, which is also referred to as the “Superpledge” agreement, is to provide additional pledged collateral in the event that the market value of the collateral pledged in the individual share pledge

agreements fell below 100% of the principal amount of the note. This agreement was substantially modified in 2004 in connection with the transfer of obligations back to Allianz AG, showing Allianz AG as the pledgor. Three issues relating to the Securities and Securities Account Pledge Agreement were noted:

- a) The Company did not notify the CDI prior to entering into this agreement, which is a violation of CIC Section 1215.5(b). As this transaction is directly related to the \$1 billion surplus contribution, the Company is required to notify the Commissioner at least 30 days prior to entering into the transaction.
 - b) The collateral requirements of the agreement do not comply with the conditions set forth by the CDI. The Company agreed to maintain collateral with a market value of at least 120% of the principal balance of the note. It is recommended the Securities Account Pledge Agreement be amended to require the market value of pledged securities to be at least 120% of the principal balance of the note.
 - c) The combined market value of the pledged securities in the individual and the superpledge accounts was \$2.86 million less than the required value at December 31, 2003. At March 31, 2004, the collateral deficiency increased to \$74.5 million. It is recommended the Company eliminate the collateral deficiency and establish monitoring procedures to ensure the collateral is at least 120% of the principal balance of the notes.
- (4) On September 15, 2003, the Company entered into a loan agreement with AZOA. Pursuant to the provisions of the loan agreement, a promissory note totaling \$300 million was executed between AZOA and the Company, whereby AZOA promised to pay interest only from the date of the agreement, until December 29, 2010, and to pay interest and principal for the remaining loan period. The loan is scheduled to mature on June 29, 2015. To enhance the investment grade rating of the promissory note, Allianz AG executed a continuing guarantee agreement whereby Allianz AG agreed to guarantee the principal and interest of the loan. Neither the loan agreement, promissory note or the

continuing guarantee agreement contain a provision whereby the loan is collateralized. CIC Section 1196(c) prohibits excess fund investments in a loan unless “the amount loaned does not exceed 85% of the market value, at the date of the loan, of the collateral taken as security.” Pursuant to the provisions of the above statute, this loan is considered a nonadmitted asset, as no collateral was pledged to secure the loan. This issue was raised with the Company during the course of the examination. To collateralize the loan, AZOA pledged 9,994,289 shares of Class A Series A Preferred Stock of Allianz Life Insurance Company of North America, an affiliated life insurance company domiciled in Minnesota. The preferred shares were valued at approximately \$365 million at September 15, 2003. AZOA terminated the guarantee agreement previously executed in order to secure the loan. The CDI approved the Company’s request to carry this loan as an admitted asset. Accordingly, the loan has been accepted per examination as reported by the Company.

- (5) The Company routinely sells overdue premiums and reinsurance recoverables to AZOA without recourse. Pursuant to the sales agreement, the Company continues to provide services pertaining to the maintenance and collection of these receivables. On a quarterly basis, monies collected by the Company are remitted to AZOA. In June 2003, the Company made an early settlement, or buy-back, from AZOA totaling \$33.7 million. Upon settlement, the Company had not collected a portion of these recoverables, resulting in the transfer of financial risk from AZOA to the Company. This transfer of risk contradicts the provision of the sales agreement that states that the sale is "without recourse." It is recommended that the Company abide by the terms of all current and future intercompany sale agreements and account for the sale transactions in accordance with SSAP No. 42 of the NAIC Accounting Practices and Procedures Manual.
- (6) The Company did not disclose on its Annual Statement a guaranty made by AZOA, whereby AZOA agreed to indemnify the Company for defaulted debentures totaling \$50 million that were issued by Grupo Financiero Bancrecer. It is recommended the Company disclose all material related party transactions in accordance with SSAP No. 25, paragraphs 17-18 of the NAIC Accounting Practices and Procedures Manual.

- (7) In May 2003, Allianz AG issued two Keep Well Agreements to the Company whereby Allianz AG agreed to contribute capital to the Company up to \$400 million if the 2003 accident year combined loss ratio exceeds the planned combined ratio of 102%, and for any adverse development up to \$1 billion for accident years 2002 and prior. The terms of the commitments commenced on January 1, 2003 and will terminate on December 31, 2005. As of December 31, 2003, the Company recorded a \$62.5 million receivable due to adverse development for accident years 2002 and prior. In April, 2004, the Company obtained approval from the CDI to treat this receivable as a capital contribution and admitted asset.
- (8) The Company guaranteed the minimum capital and surplus levels for three of its subsidiaries: Interstate Indemnity Company, Fireman's Fund Insurance Company of Nebraska and Fireman's Fund Insurance Company of Wisconsin. Also, the Company guaranteed the obligations of Interstate Insurance Group under their Agency Agreement with Bertholon-Rowland as well as the obligations of Parkway Insurance Company under their marketing relationship with J&H Marsh & McLennan, Inc.
- (9) The Company received dividends from its subsidiaries as shown in the schedule below:

Subsidiary	2000	2001	2002	2003	2004
Allianz Cash Pool	\$ 274,640	\$ 175,636	\$ 625,388	\$19,551	\$0
American Automobile Ins. Co.	36,000,000	34,600,000	-	-	-
FFIC of Texas	14,072,319	4,200,000	3,669,000	-	-
Interstate National Corp.	19,000,000	21,300,000	18,556,000	-	-
National Surety Corp.	11,000,000	11,100,000	8,744,000	-	-
San Francisco Reins. Co.	31,694,600	-	18,377,000	-	-
All other	-	766,946	-	-	-
Totals	\$112,041,559	\$72,142,582	\$49,971,388	\$19,551	\$0

TERRITORY AND PLAN OF OPERATION

The Company is licensed to transact insurance in all states of the United States, the District of Columbia, Guam, Puerto Rico, the U.S. Virgin Islands, and Canada. In addition, the Company is licensed by the United States Treasury Department to underwrite surety business.

Under terms of the intercompany reinsurance agreements, most of the underwriting transactions of the Company are pooled, reapportioned and then distributed to the ten members of the pool, as discussed under the caption “Reinsurance.”

The Company conducts its operations jointly with its subsidiaries through its home office in Novato, California. Multiple line operations are conducted nationwide through an extensive network of field and service offices. Each field office contains facilities for production, underwriting, claims, loss control, and premium auditing.

The Company and its subsidiaries (Group) rank among the largest insurance groups domiciled in the United States. In 2003, the Group produced \$4.1 billion of direct premiums through approximately 3,700 agents. The Group writes all lines of property and casualty business through five business units: Commercial, Personal, Marine, Interstate, and Agribusiness.

The Group also participates in underwriting pools, syndicates, associations, exchanges, and various state Fair Plans, including business underwritten or serviced by the American Cargo War Risk, the American Hull Insurance Syndicate, the American Nuclear Insurers, the Associated Aviation Underwriters, the Industrial Risk Insurers, and the Cargo Reinsurance Association.

In 2003, 26% of the Group’s direct premiums were written in California. The following five states accounted for an aggregate of another 27% of premiums written: New York, 9%; Florida, 5%; Texas, 5%; New Jersey, 4%, and Illinois, 4%.

REINSURANCE

Intercompany Reinsurance Agreement

The Company is the lead insurer in an intercompany reinsurance agreement (agreement) with nine of its affiliates (hereinafter also referred to as the “participants”). Under the terms of this agreement, the participants cede, and the Company assumes, 100% of the participants’ business generated from underwriting operations. The cessions from the participants are combined with the Company’s business, resulting in the pooled balance to be allocated to each company in the pool. The following table illustrates each participant’s pooled share as of December 31, 2003:

<u>Company</u>	<u>State of Domicile</u>	<u>Pooling Share</u>
Fireman’s Fund Insurance Company	CA	75.0%
The American Insurance Company	NE	11.5%
National Surety Corporation	IL	4.0%
American Automobile Insurance Company	MO	2.5%
Associated Indemnity Corporation	CA	1.0%
Fireman’s Fund Insurance Company of Ohio	OH	0.2%
Interstate Fire & Casualty Company	IL	3.5%
Chicago Insurance Company	IL	1.5%
Interstate Indemnity Company	IL	0.8%
Fireman’s Fund Insurance Company of Wisconsin **	WI	<u>0.0%</u>
Total		<u>100.0%</u>

**effective January 1, 2003, the agreement was amended to change Fireman’s Fund Insurance Company of Wisconsin’s share of the retrocession from 0.1% to 0.0% and the Company’s share from 74.9% to 75.0%

Effective January 1, 1999 the agreement was revised and expanded to consolidate two separate pools into a single pool. Other subsidiaries of the Company, referred to as “Specialty Companies,” cede 100% to the pool, but do not assume any portion of the pooled balances. These companies receive a commission from the Company, and also pay the Company a management fee, resulting in minimal income.

Three companies in the pool - Interstate Fire and Casualty Company, Interstate Indemnity Company and Chicago Insurance Company - submit business to the pool net of reinsurance arrangements with third parties.

The agreement authorizes and empowers the Company to: (1) collect and receive all premiums; (2) adjust and pay all losses; (3) reinsure or cancel any and all policies and contracts of insurance; and (4) act as though the policies and contracts of insurance and reinsurance were issued by the Company. It further provides for the complete sharing of all income and expenses of the pooled business with the exception of the investment operations, dividends to policyholders, liabilities for federal income tax or other items not relating to the underwriting operations of the parties. Accounts are required to be settled quarterly.

Other Intercompany Reinsurance

Prior to the pooling of business among the participating companies, certain other business is assumed and/or ceded between the Company and other affiliated companies. These companies contribute to the pool but do not receive a percentage back from the pool. Instead, these affiliates receive a 3.25% commission fee. The Company assumes all business written by the following subsidiaries:

Fireman's Fund County Mutual Insurance Company
Fireman's Fund Indemnity Corporation
Fireman's Fund Insurance Company of Georgia
Fireman's Fund Insurance Company of Hawaii
Fireman's Fund Insurance Company of Louisiana
Fireman's Fund Insurance Company of Missouri
Midway Insurance Company of Illinois

In addition, the Company has a variety of reinsurance arrangements with the following affiliates that do not participate in any pooling activities:

Allianz Global Risks US Insurance Company
Fireman's Fund Insurance Company of Nebraska
Fireman's Fund Insurance Company of Texas
San Francisco Reinsurance Company
Vintage Insurance Company

The Company also provides reinsurance facilities to American Standard Lloyd's Insurance Company, acting by and through its Attorney-in-Fact, Standard General Agency, Inc. All business underwritten or assumed by American Standard Lloyd's Insurance Company is ceded 100% to Associated Indemnity Corporation and then to the intercompany pool.

Assumed

In addition to intercompany agreements, the Company assumes business from pools and associations and from various companies under several reinsurance agreements.

Loss Portfolio Transfer

On September 30, 2002, coincident with the completion of an updated asbestos and environmental (A&E) reserve study, the Company entered into a loss portfolio transfer agreement with Allianz Aktiengesellschaft (Allianz AG). Based on the updated reserve study, the Company increased gross and net A&E reserves by \$750 million. Under the terms of this agreement, Allianz AG assumed losses associated with A&E claims for a maximum of \$2,158,500,000 for accident years 1987 and prior. In lieu of having the Company pay the full premium of \$1,276,000,000, Allianz AG dismissed \$1.1 billion of premium payment by assigning the premium to Allianz of America, Inc. (AZOA), which, in turn, assigned the premium to Allianz Global Risks US Insurance Company (AGR). AGR then assigned the premium payment back to the Company as a capital contribution. Therefore, no cash was actually exchanged for the \$1.1 billion premium payment. A trust account was established by the Company for the remaining \$176 million.

The prospective treatment of the contract was approved by the California Department of Insurance (CDI), as it met the requirements for a prospective agreement defined under SSAP No. 62, paragraph 30 (d).

Ceded

Reinsurance, other than intercompany, is placed by the Company for the Fireman's Fund Insurance Companies' Group ("Group"). All members of the Group, either individually or collectively, may utilize the reinsurance of the various contracts that are in effect.

The Company utilizes the facultative market, as needed, to increase its capacity. Senior management provides a list of acceptable facultative markets to the field underwriting staff.

The Company maintains an active program of providing "Fronting" for unaffiliated insurers in what is called their captive markets. The Company produces business that is ceded under contracts specifically designed for the market and the reinsurer.

The following schedule lists principal ceded reinsurance agreements in force as of the examination date:

<u>Line of Business and Type of Contract</u>	<u>Reinsurer's Name</u>	<u>Company's Retention</u>	<u>Reinsurer's Limit</u>
<u>Casualty:</u>			
<u>Per Risk Excess of Loss</u>			
First Layer	7 domestic and foreign companies	\$10,000,000 each and every occurrence, each and every risk	\$15million excess \$10million, each and every occurrence, each and every risk, not to exceed \$15 million each and every occurrence, each and every risk . Acts of Terrorism only \$30 million aggregate
Second Layer	7 domestic and foreign companies	\$25,000,000 per occurrence, each and every risk	\$25million excess \$25million, each and every occurrence, each and every risk, not to exceed \$25 million each and every occurrence, each and every risk. Acts of Terrorism only \$50 million in aggregate
<u>Property:</u>			
<u>Property – Per Risk XOL</u>			
First layer	Various domestic, foreign and alien companies led by Allianz and Swiss Re America	\$15,000,000 each and every loss/risk	\$10 million excess \$15 million, each and every loss/risk, not to exceed \$30 million per occurrence; limited to \$50 million

<u>Line of Business and Type of Contract</u>	<u>Reinsurer's Name</u>	<u>Company's Retention</u>	<u>Reinsurer's Limit</u>
Second layer	Various domestic, foreign and alien companies led by Allianz and Allied World Assurance	\$25,000,000 each and every loss/risk	\$25 million excess \$25 million, each and every loss/risk, not to exceed \$50 million occurrence; limited to \$100 million
Third layer	Various domestic, foreign and alien companies led by Allianz and Axis Specialty Limited	\$50,000,000 each and every loss/risk	\$50 million excess \$50 million, each and every loss/risk, not to exceed \$50 million per occurrence, limited to \$100 million
Fourth Layer	Various domestic, foreign and alien companies led by Allianz and Axis Specialty Limited	\$100,000,000 each and every loss/risk	\$50 million excess \$100 million, each and every loss/risk, not to exceed \$100 per occurrence; limited to \$100 million
<u>Property Catastrophe Excess of Loss</u>			
First layer	8 brokered, 2 direct: domestic, foreign and alien companies led by Allianz AG	\$150,000,000 loss/losses/one event	\$50 million excess \$150 million, loss/losses/one event, not to exceed \$50 million per occurrence; limited to \$100 million
Catastrophe Excess of Loss Second Layer	17 brokered, 3 direct: domestic, foreign and alien companies led by Allianz AG	\$200,000,000 loss/losses/one event	\$100 million excess \$200 million, loss/losses/one event, not to exceed \$100 million occurrence; limited to \$200 million
Catastrophe Excess of Loss Third Layer	21 brokered, 3 direct: domestic, foreign and alien companies led by Allianz AG	\$300,000,000 loss/losses/one event	\$100 million excess \$300 million, loss/losses/one event, not to exceed \$100 million per occurrence, limited to \$200 million
<u>Catastrophe Excess of Loss (RV LUX)</u>			
	International Reins. Co. SA 100%	\$400,000,000 loss/losses/one event	\$300 million excess \$400 million, disaster(s) arising out of one event, not to exceed \$300 million each loss occurrence; no more than \$600 million during any one annual period
<u>Aggregate Excess of Loss 1999 yr</u>			
	Swiss Reinsurance Company, Ltd. (Novated to Swiss Re In 2003)	Greater of 68.5% of net earned premium or total ultimate net loss less the aggregate limit \$390 million	Lesser of 15% of premium, or \$585,000,000 or 125% of ceded losses for 1999
<u>Aggregate Excess of Loss 2000 yr</u>			
	Swiss Reinsurance Company, Ltd. (Novated to Swiss Re In 2003)	Greater of 68.5% of net earned premium or total ultimate net loss less the aggregate limit \$390	Lesser of 15% premium, or \$585,000,000 or 100% of ceded losses for 2000
<u>Aggregate Excess of Loss 2001 yr</u>			
	Swiss Reinsurance Company, Ltd.	Aggregate limit of \$400 million	Lesser of 15% of premium, or \$592,500,000 or 100% of ceded losses for 2001

<u>Line of Business and Type of Contract</u>	<u>Reinsurer's Name</u>	<u>Company's Retention</u>	<u>Reinsurer's Limit</u>
<u>Inland Marine and Property Per Risk and Occurrence Excess of Loss</u>			
First Layer	7 brokered, 2 direct: domestic, foreign and alien companies led by Axis Specialty Ltd.	\$5 million each and every loss/occurrence(s)/one event	\$5 million excess \$5 million, each and every loss/occurrence(s)/one event; no more than \$15 million
Second Layer	7 brokered, 2 direct: domestic, foreign and alien companies led by Axis Specialty Ltd.	\$10 million each and every loss/occurrence(s)/one event	\$5 million excess \$10 million, each and every loss/occurrence(s)/one event; no more than \$10 million
Third Layer	7 brokered, 2 direct: domestic, foreign and alien companies led by Axis Specialty Ltd.	\$15 million, each and every loss/occurrence(s)/one event	\$5 million excess \$15 million, each and every loss/occurrence(s)/one event; no more than \$10 million
<u>Marine Whole - Excess of Loss (Ocean, Inland and Property)</u>			
First layer	Lloyds(brokered), 11 brokered, 2 direct: domestic, foreign and alien companies led by Cornhill Insurance PLC "T" account and Alea Group	\$7.5 million, each and every loss/occurrences(s)/one event	\$7.5 million in excess \$7.5 million, each and every loss/occurrence(s)/one event; no more than \$15 million
Second Layer	3 Lloyds syndicates, 6 brokered, 2 direct: domestic, foreign and alien companies led by Cornhill Insurance PLC "T" account and Alea Group	\$15 million, each and every loss/occurrence(s)/one event	\$15 million in excess \$15 million, each and every loss/occurrence(s)/one event, no more than \$30 million
Third Layer	4 Lloyds syndicates, 8 domestic, foreign and alien companies, 1 direct company led by Cornhill Insurance PLC "T" account and Alea Group	\$30 million, each and every loss/occurrence(s)/one event	\$20 million in excess \$30 million, each and every loss/occurrence(s); no more than \$40 million
<u>Entertainment:</u> (film and completion guarantee)			
<u>Entertainment-Excess of Loss</u>			
First Layer	5 Lloyds brokers and 8 direct: domestic, foreign and alien companies	1st layer - \$6.5 million Section A or Sections A and B and/or C or Sections B and C And Production business or Non-Production Business (inclusive of underlying reinsurance)	Production: \$6 million excess \$6.5 million, each and every loss, each production, not to exceed \$6 million each loss, each production. Non-Production: same as production except each insured replaces each production. Contract term not to exceed \$24 million

<u>Line of Business and Type of Contract</u>	<u>Reinsurer's Name</u>	<u>Company's Retention</u>	<u>Reinsurer's Limit</u>
Second Layer	6 Lloyds brokers, 1 direct: domestic, foreign and alien companies	2nd layer - \$12.5 million Section A or Sections A and B and/or C or Sections B and C And Production business or Non-Production Business (inclusive of underlying reinsurance)	Production: \$12.5 million excess \$12.5 million, each and every loss, each production, not to exceed \$12.5 million each loss, each production. Non-Production: same as production except each insured replaces each production. Contract term not to exceed \$50 million
Third Layer	8 Lloyds brokers, 1 direct: domestic, foreign and alien companies	3rd layer - \$25 million Section A or Sections A and B and/or C or Sections B and C And Production business or Non-Production Business	Production: \$25 million excess \$25 million, each and every loss, each production, not to exceed \$25 million each loss, each production. Non-Production: same as production except each insured replaces each production. Contract term not to exceed \$50 million
Fourth Layer	8 Lloyds brokers, 8 domestic: domestic, foreign and alien companies	4th layer - \$50 million Section A or Sections A and B and/or C or Sections B and C And Production business or Non-Production Business	Production: \$50 million excess \$50 million, each and every loss, each production, not to exceed \$30 million each loss, each production. Non-Production: same as production except each insured replaces each production. Contract term not to exceed \$100 million

Intermediary Clause

The intermediary clause of the Marine Risk and Occurrence, Inland Marine and Marine Whole Excess of Loss contracts lists only Willis Re Inc. as the intermediary-broker. California Insurance Code (CIC) Section 1781.4 requires that “transactions between a reinsurance intermediary-broker and the insurer it represents in that capacity shall only be entered into pursuant to a written authorization specifying the responsibilities of each party.” Since Guy Carpenter receives payments to and from the reinsurer, it is performing those duties in the capacity of an intermediary-broker, thus is subject to the provisions of CIC Section 1781.4. The Company has a broker authorization agreement with Willis Re Inc., which contains a clause that Guy Carpenter is acting as co-broker, but this agreement makes no mention of the duties of Guy Carpenter. Guy Carpenter is performing duties of an intermediary and therefore should be subject to the same provisions. It is recommended

that the Company modify the intermediary clause of the marine reinsurance treaties as well as the broker authorization agreement to include Guy Carpenter as an intermediary-broker.

Letters of Credit

In accordance with CIC Section 922.5(b), the Commissioner shall allow credit for reinsurance ceded by a domestic insurer to an assuming insurer in an amount not exceeding the liabilities carried by the ceding insurer and to the extent that security is provided in the form of a letter of credit, satisfactory to the Commissioner. Several letters of credit contained reference to letters of credit that had expired, which is not permitted under the provisions of CIC Section 922.5, 922.7 and California Department of Insurance Bulletin 97-5. It is recommended the Company remove these references from the letters of credit upon their renewal.

ACCOUNTS AND RECORDS

Information Systems Controls

During the course of the examination, a review was made of the Company's general controls over its information systems. As the result of this review, recommendations for improving the Company's information systems controls were developed and presented to the Company. The recommendations covered areas such as logical security, physical security and program changes. The Company should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems.

Notes to the Financial Statements

The following errors were noted in the Notes to the Financial Statements section of the Company's Annual Statement:

Disclosure Requirements of Surplus Contribution: In September, 2001 the California Department of Insurance granted Allianz Global Risks US Insurance Company (AGR), approval under a permitted

accounting practice to record a \$1 billion surplus contribution to the Company. The Company disclosed the capital contributions in its 2001 and 2002 Annual Statements; however, it did not disclose the monetary effect of such transactions on net income and statutory surplus in accordance with SSAP No.1, paragraph 7, of the NAIC Accounting Practices and Procedures Manual. In 2003, the Company disclosed the monetary effect on statutory surplus, but not on net income. It is recommended that the Company provide full disclosure of any accounting practices that depart from the NAIC Accounting Practices and Procedures Manual in accordance with SSAP No.1, paragraph 7.

Structured Settlements: The Company did not properly complete this note as required by SSAP No. 65, paragraph 19 of the NAIC Annual Statement Instructions. The NAIC Annual Statement Instructions require that companies report the amount of loss reserves eliminated by annuities and also the extent to which the company is contingently liable for such amounts should the issuers of the annuities fail to perform under the terms of the annuities. The Company reported only for those amounts that exceeded 1% of policyholders' surplus, but should have reported the total amount for all life insurers.

Additionally, for annuities due from any life insurer that exceeds 1%, in the aggregate, of policyholders' surplus, companies are required to report the name, location, aggregate statement value (i.e., present value of annuities) and disclose whether the life insurers are licensed in the company's state of domicile,. The Company reported the statement value for all life insurers, but should have reported only for those amounts that exceeded 1% of policyholders' surplus. Also, the Company did not disclose whether the life insurers are licensed in California.

Reconciliation of General Ledger Accounts

During the review of the Company's reconciliation of certain general ledger accounts, it was noted that the Company relied on a sub-ledger balance as an acceptable form of supporting documentation without reconciling the sub-ledger balance to the detail. The Company also used e-mail as supporting documentation, although less common. It is recommended that the Company implement controls to ensure that general ledger accounts are reconciled to the system from which the data feeding the general ledger resides.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2003

Underwriting and Investment Exhibit for the Year Ended December 31, 2003

Reconciliation of Surplus as Regards Policyholders from December 31, 1999
through December 31, 2003

Reconciliation of Examination Changes as of December 31, 2003

Statement of Financial Condition
as of December 31, 2003

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 6,999,453,504	\$	\$ 6,999,453,504	(1)
Preferred stocks	222,890,386		222,890,386	
Common stocks	1,434,486,030		1,434,486,030	(2)
Real estate	208,293		208,293	
Cash and short-term investments	177,748,466		177,748,466	
Other invested assets	182,803,365		182,803,365	(3)
Receivable for securities	378,239		378,239	
Aggregate write-ins for invested assets				
Investment income due and accrued	63,252,374		63,252,374	
Uncollected premiums and agents' balances in the course of collection	416,569,122	61,974,025	354,595,097	(4)
Deferred premiums, agents' balances and installments booked but deferred and not yet due	150,825,779	1,121,267	149,704,512	(5)
Accrued retrospective premiums	5,631,370	1,087,191	4,44,179	
Amount recoverable from reinsurers	200,406,791		200,406,791	(6)
Funds held by or deposited with reinsured companies	3,461,446		3,461,446	
Net deferred tax asset	864,368,037	654,132,057	210,235,980	
Guaranty funds receivable or on deposit	4,018,126		4,018,126	
Electronic data processing equipment and software	3,803,568		3,803,568	
Furniture and equipment, including health care delivery assets	38,169,541	38,169,541	0	
Other assets nonadmitted	30,870,146	26,186,294	4,683,852	
Aggregate write-ins for other than invested assets	<u>450,253,949</u>	<u>32,668,928</u>	<u>417,585,021</u>	
Total assets	<u>\$11,249,598,532</u>	<u>\$ 815,339,303</u>	<u>\$10,434,259,229</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Losses			\$ 3,491,309,728	(7)
Reinsurance payable on paid loss and loss adjustment expenses			1,527,157	
Loss adjustment expenses			682,490,272	(7)
Commissions payable, contingent commissions and other similar charges			86,494,343	
Other expenses			52,601,842	
Taxes, licenses and fees			47,035,730	
Current federal and foreign income taxes			36,270,433	
Unearned premiums			1,343,347,452	
Advance premiums			(74,310)	
Dividends declared and unpaid - Policyholders			5,616,468	(8)
Ceded reinsurance premiums payable			32,258,020	
Funds held by company under reinsurance treaties			1,202,658,324	
Amounts withheld or retained by company for account of others			1,958,782	
Provision for reinsurance			118,185,027	
Drafts outstanding			184,308	
Payable to parent, subsidiaries and affiliates			19,137,109	
Aggregate write-ins for liabilities			<u>1,112,214,265</u>	
Total liabilities			8,233,214,950	
Common capital stock		\$ 4,200,000		
Gross paid-in and contributed surplus		4,173,815,904		
Unassigned funds (surplus)		<u>(1,976,971,625)</u>		
Surplus as regards policyholders			<u>2,201,044,279</u>	
Total liabilities, surplus and other funds			<u>\$10,434,259,229</u>	

Underwriting and Investment Exhibit
for the Year Ended December 31, 2003

Statement of Income

Underwriting Income

Premiums earned		\$ 2,919,523,198
Deductions:		
Losses incurred	\$ 2,079,905,448	
Loss expenses incurred	450,387,610	
Other underwriting expenses incurred	950,637,618	
Aggregate write-ins for underwriting deductions	<u>1,133,748</u>	
Total underwriting deductions		<u>3,482,064,424</u>
Net underwriting loss		(562,541,226)

Investment Income

Net investment income earned	\$ 376,528,040	
Net realized capital losses	<u>(24,837,039)</u>	
Net investment gain		<u>351,691,001</u>

Other Income

Net loss from agents' or premium balances charged off	\$ (6,010,475)	
Aggregate write-ins for miscellaneous income	<u>(153,634,395)</u>	
Total other income		<u>(159,644,870)</u>
Net loss before dividends to policyholders and before federal and foreign income taxes		(370,495,095)
Dividends to policyholders		3,871,634
Federal and foreign income taxes incurred		<u>(35,455,651)</u>
Net loss		<u>\$ (338,911,078)</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 2002		\$ 2,239,490,115
Net loss	\$(338,911,078)	
Change in net unrealized capital gains	330,157,967	
Change in net unrealized foreign exchange capital loss	(92,623)	
Change in net deferred income tax	811,413,037	
Change in nonadmitted assets	(673,472,046)	
Change in provision for reinsurance	9,053,762	
Aggregate write-ins for losses in surplus	<u>(176,594,855)</u>	
Change in surplus as regards policyholders		<u>(38,445,836)</u>
Surplus as regards policyholders, December 31, 2003		<u>\$2,201,044,279</u>

Reconciliation of Surplus as Regards Policyholders
from December 31, 1999 through December 31, 2003

Surplus as regards policyholders, December 31, 1999 per Examination	\$3,252,401,141
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	Gain in Surplus	Loss in Surplus
Net loss	\$	\$1,950,165,402
Change in net unrealized capital losses		1,528,940,428
Change in net foreign exchange capital gain	198,922	
Change in net deferred income tax	643,947,037	
Change in nonadmitted assets		567,176,196
Change in provision for reinsurance		29,179,270
Cumulative effect of changes in accounting principles	84,104,291	
Surplus adjustments: Paid-in	2,703,000,006	
Dividends to stockholders (cash)		200,000,000
Aggregate write-ins for losses in surplus		207,145,822
Total gains and losses	<u>\$3,431,250,256</u>	<u>\$4,482,607,118</u>

Net decrease in surplus as regards policyholders	<u>1,051,356,862</u>
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Surplus as regards policyholders, December 31, 2003, per Examination	<u><u>\$2,201,044,279</u></u>
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Reconciliation of Examination Changes
as of December 31, 2003

	<u>Per Company</u>	<u>Per Examination</u>	<u>Surplus Increase (Decrease)</u>	<u>Notes</u>
<u>Assets</u>				
Common stocks	\$1,632,883,777	\$1,434,486,030	\$ (198,397,747)	(2)
Other invested assets	185,658,217	182,803,365	(2,854,852)	(3)
<u>Liabilities</u>				
Losses and loss adjustment expenses	3,720,142,202	4,173,800,000	(453,657,798)	(7)
Dividends declared and unpaid: Policyholders	2,705,262	5,616,468	<u>(2,911,206)</u>	(8)
Net decrease to surplus			(657,821,603)	
Surplus as regards policyholders, December 31, 2003, per Company			<u>2,858,865,882</u>	
Surplus as regards policyholders, December 31, 2003, per Examination			<u>\$2,201,044,279</u>	

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds

The Custodian Agreement (Agreement) dated October 1, 1998 between the Company and Mellon Trust of California does not adhere to the guidance regarding Custodial and Safekeeping Agreements provided by the National Association of Insurance Commissioners' Financial Examiners Handbook in the following areas:

- a) The Agreement states: "At its option, the Custodian may commingle any assets deposited hereunder with assets held by the Custodian on behalf of others". The Agreement should clearly state that certificated securities of the insurance company shall be held separate from all other securities or in a fungible bulk. Those securities held in a fungible bulk by the custodian, in a clearing corporation, or in the Federal Reserve book-entry system, shall be separately identified on the custodian's official records as being owned by the insurance company.
- b) The Agreement did not contain a clause requiring that should the Agreement be terminated, or if 100% of the account assets in any one custody account are withdrawn, the custodian shall provide written notification, within three business days of the termination or withdrawal, to the insurer's domiciliary commissioner.
- c) The Agreement did not contain a clause requiring that the custodian and its agents, upon reasonable request, be required to send all reports which they receive from a clearing corporation or the Federal Reserve book-entry system that the clearing corporation or the Federal Reserve permits to be redistributed and reports prepared by the custodian's outside auditors, to the insurance company on their respective systems of internal control.
- d) The Agreement did not contain a clause requiring that the custodian secure and maintain insurance protection in an adequate amount.

It is recommended the Company revise its Custodian Agreement with Mellon Trust of California to include provisions recommended by the National Association of Insurance Commissioners' Financial Examiners Handbook. It is also recommended the Company submit the revised Agreement to the California Department of Insurance (CDI) for approval.

(2) Common Stocks

The captioned asset was determined to be \$1,434,486,030 per examination, a decrease of \$198,397,747. This decrease is the result of:

- The Company classified Allianz Cash Pool LLC, a limited liability company, as common stock and reported it on Schedule D, Part 2, Section 2. SSAP No. 48, paragraph 6 of the NAIC Accounting Practices and Procedures Manual specifies that investments in joint ventures, partnership and limited liability companies be reported on Schedule BA, Other Invested Assets. The value of the Allianz Cash Pool LLC at December 31, 2003 was \$47,145,148. This asset has been reclassified to Other Invested Assets per examination.
- Differences of \$151,252,599 were due to adjustments to the statutory value of affiliates owned by the Company. These adjustments were the result of loss and loss adjustment expense reserve deficiencies noted by the CDI's consulting actuary in the actuarial analysis of the pool.

It is recommended that the Company classify Allianz Cash Pool, LLC as Other Invested Assets and report it in Schedule BA.

(3) Other Invested Assets

The captioned asset was determined to be \$182,803,365 per examination, which reflects a net reduction totaling \$2,854,852. These adjustments are the net result of two issues:

(1) Reclassification of the Company's investment in Allianz Cash Pool LLC, from common stocks. This amounted to \$47,145,148 (Refer to write up under Common Stocks); and,

(2) The Company's investment of \$50 million in debentures issued by Grupo Financiero Bancrecer (Bancrecer) was non-admitted per examination:

At December 31, 2003 the Company owned \$50 million in debentures issued by Grupo Financiero Bancrecer (Bancrecer). On October 14, 1999, Bancrecer defaulted on its payment obligations. As a result, the Mexican government seized control of Bancrecer's assets and took action to liquidate the assets and compromise the debts of Bancrecer. While Mexican peso debenture holders were paid in full, Bancrecer failed to repurchase the Company's debentures. The Company instituted a claim and demand for arbitration against the government of Mexico under the North America Free Trade Agreement and the laws of Mexico in order to recover the full amount of its original investment and other relief.

Under a guaranty issued by Allianz of America, Inc. (AZOA) on November 30, 1999, AZOA agreed to pay the Company the difference between the amount the Company recovered under the arbitration proceeding and the value of the original purchase price plus accrued but unpaid interest from the date of default, plus attorney's fees and costs incurred in connection with the recovery efforts.

To date, this litigation has not been settled. The Company continues to report this asset on Schedule BA as an admitted asset. Also, under the terms of the guaranty agreement, AZOA cannot honor the guaranty until all legal remedies are exhausted.

This asset is nonadmitted per examination on the following basis:

1) SSAP No. 4 of NAIC Accounting Practices and Procedures Manual states that "assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet, and are, therefore, considered non-admitted."

2) The guaranty agreement between the Company and AZOA does not provide collateral to secure the guaranty.

The Company valued all Schedule BA assets using the equity method as stated in SSAP No. 48. There was no distinction between entities with less than 10% ownership and entities with more than 10% ownership. Although no material differences were noted between the two methods, it is recommended the Company value other invested assets in accordance with SSAP No. 46 and SSAP No. 48 of the NAIC Accounting Practices and Procedures Manual.

(4) Uncollected Premiums and Agents' Balances in Course of Collection

The Company could not provide an aging detail on a policy-by-policy basis for all of the over ninety day components of this asset. Consequently, it was unable to determine compliance with SSAP No. 6, paragraph 7, which addresses the determination of the due date of premium balances due a company. It is recommended that the Company implement procedures to ensure that over ninety balances due can be supported by the underlying policy level detail.

(5) Deferred Premiums, Agents' Balances, and Installments Booked but Deferred and Not Yet Due

Members of the intercompany reinsurance pool ceded deferred premiums to the Company, but the Company did not retrocede the members' portion of the pooled balance back to the member. The pooled balance of such deferred premium amounted to \$18,844,032. No examination change was made, as the offsetting entry is to intercompany payables. It is recommended the Company implement controls to ensure that all accounts subject to pooling are properly pooled and allocated to each member.

(6) Amounts Recoverable from Reinsurers

The Company applies reinsurance premiums payable against reinsurance recoverables on paid losses. SSAP No. 62, paragraph 19 prohibits the offset of such balances. It is recommended the

Company implement procedures and controls to ensure that reinsurance premiums payable are not offset against reinsurance recoverables on paid losses.

(7) Losses and Loss Adjustment Expenses

The CDI, pursuant to California Insurance Code (CIC) Section 733(g), retained a consulting actuary for the purpose of providing a full actuarial evaluation of the Company's loss and loss adjustment expense reserves as of December 31, 2003. Based on the analyses performed by the CDI's consulting actuary, it was determined that the range of probable loss and loss adjustment expense reserve estimates varied from a low of \$5,009,000,000 to a high of \$6,121,800,000. This is the range estimate for all companies participating in the intercompany reinsurance agreement. The CDI has determined its best estimate of loss and loss adjustment expense reserves to be \$5,565,100,000, which reflects a reserve deficiency of \$604,910,000. As a pooled account, 75% of loss and loss adjustment expense reserves, or \$453,660,000 would be allocated to the Company. Refer to the table below for the carried versus estimated reserves for each company in the pool:

Company	Pool Percent	Per Examination	Per Company	Deficiency
Fireman's Fund Insurance Company	75.0%	\$4,173.8	\$3,720.14	\$453.66
The American Insurance Company	11.5%	640.0	570.42	69.58
National Surety Corporation	4.0%	222.6	198.41	24.19
Interstate Fire & Casualty	3.5%	194.8	173.61	21.19
American Automobile Insurance Company	2.5%	139.1	124.00	15.10
Chicago Insurance Company	1.5%	83.5	74.40	9.10
Associated Indemnity Corporation	1.0%	55.7	49.60	6.10
Interstate Indemnity Company	0.8%	44.5	39.68	4.82
Fireman's Fund Insurance Company of Ohio	0.2%	11.1	9.92	1.18
Fireman's Fund Insurance Company of Wisconsin	0.0%	0.0	0.0	0.00
	100.00%	\$5,565.1	\$4,960.19	\$604.91

(8) Dividends Declared and Unpaid – Policyholders

The Company did not accrue a payable for policyholder dividends when the dividends were declared. Policyholder dividends of \$3,881,608 were declared in December, 2003, but not recorded by the Company until May, 2004. As a pooled account, 75% of the declared dividend, or \$2,911,206 would be allocated to the Company. Accordingly, an examination adjustment was made for this

amount. It is recommended that the Company record policyholder dividends payable in the period in which they are declared.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Related Party Transactions (Page 9): The following recommendations all relate to the \$1 billion surplus contribution made to the Company in September, 2001 by Allianz Global Risks US Insurance Company (AGR):

1. It is recommended the share pledge agreements be amended to require that the market value of pledged securities be at least 120% of the principal balance of the note.
2. It is recommended the Company implement controls to ensure that legally binding agreements between affiliates are enforced. Additionally, pursuant to California Insurance Code (CIC) Section 1215.5(b), it is recommended that the Company notify the California Department of Insurance (CDI) at least 30 days prior to entering into agreements with its affiliates.
3. The following three recommendations relate to the Securities and Securities Account Pledge Agreement:
 - a) Pursuant to CIC Section 1215.5(b), it is recommended that the Company notify the CDI at least 30 days prior to entering into agreements with its affiliates.
 - b) It is recommended this agreement be amended to require the market value of pledged securities be at least 120% of the principal balance of the note.
 - c) It is recommended the Company eliminate collateral deficiencies and establish monitoring procedures to ensure the collateral is at least 120% of the principal balance of the notes.

Management and Control – Related Party Transactions (Page 9): It is recommended that the Company abide by the terms of all current and future intercompany sale agreements and account for the sale transactions in accordance with SSAP No. 42 of the NAIC Accounting Practices and Procedures Manual.

Management and Control – Related Party Transactions (Page 9): It is recommended the Company disclose all material related party transactions in accordance with SSAP No. 25, paragraphs 17-18, of the NAIC Accounting Practices and Procedures Manual

Reinsurance - Intermediary Clause (Page 21): It is recommended that the Company modify the intermediary clause of the marine reinsurance treaties as well as the broker authorization agreement to include Guy Carpenter as an intermediary-broker.

Reinsurance - Letters of Credit (Page 22): It is recommended the Company remove the references letters of credit that had expired from the letters of credit upon their renewal.

Accounts and Records – Information System Controls (Page 22): The Company should evaluate the recommendations from the information systems controls review and make appropriate changes to strengthen its controls over its information systems.

Accounts and Records – Notes to Financial Statements (Page 22): It is recommended that the Company provide full disclosure in the Annual Statement of any accounting practices that depart from the NAIC accounting practices and procedures in accordance with SSAP No.1 paragraph 7 of the NAIC Accounting Practices and Procedures Manual.

Accounts and Records – Reconciliation of General Ledger Accounts (Page 23): It is recommended that the Company implement controls to ensure that general ledger accounts are reconciled to the system from which the data feeding the general ledger resides.

Comments on Financial Statement Items – Bonds (Page 29): It is recommended the Company revise its Custodial Agreement with Mellon Trust of California to include provisions recommended by the NAIC Financial Examiners Handbook. It is also recommended the Company submit the revised Agreement to the CDI for approval.

Comments on Financial Statement Items – Common Stocks (Page 30): It is recommended that the Company classify Allianz Cash Pool, LLC as Other Invested Assets and report it in Schedule BA.

Comments on Financial Statement Items – Other Invested Assets (Page 30): It is recommended the Company non-admit assets that are unavailable due to encumbrances or other third party interests.

Comments on Financial Statement Items – Other Invested Assets (Page 30): It is recommended the Company value other invested assets in accordance with SSAP No. 46 and SSAP No. 48 of the NAIC Accounting Practices and Procedures Manual.

Comments on Financial Statement Items – Uncollected Premiums and Agents' Balances in Course of Collection (Page 32): It is recommended that the Company implement procedures to ensure that over ninety balances due can be supported by the underlying policy level detail.

Comments on Financial Statement Items – Deferred Premiums, Agents' Balances, and Installments Booked but Deferred and not yet Due (Page 32): It is recommended the Company implement controls to ensure that all accounts subject to pooling are properly pooled and allocated to each member.

Comments on Financial Statement Items – Amounts Recoverable from Reinsurers (Page 32): It is recommended the Company implement procedures and controls to ensure that reinsurance premiums payable are not offset against reinsurance recoverables on paid losses.

Comments on Financial Statement Items – Dividends Declared and Unpaid – Policyholders (Page 33): It is recommended that the Company record policyholder dividends payable in the period in which they are declared.

Previous Report of Examination

Accounts and Records - (Page 14): It was recommended the Company institute policies and procedures to analyze and evaluate general ledger accounts on a regular basis. The Company performed a review of general ledger accounts and implemented controls to ensure that the general ledger accounts are reviewed and reconciled on a timely basis.

Comments on Financial Statement Items - Bonds, Stocks and Short-Term Investments (Page 18): It was recommended the Company obtain approval from the CDI of its custodial agreement with the Mellon Bank of California. The current custodial agreement did not contain provisions recommended by the NAIC Financial Examiners Handbook. Accordingly, it is recommended the Company submit the revised agreement to the CDI for approval.

ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Company's officers and employees during the course of this examination.

Respectfully submitted,

_____/S/
Gordon M. Curtis, CFE, CISA
Examiner-In-Charge
Department of Insurance
State of California

_____/S/
Dennis Kluk, CFE
Representing New Jersey Department
of Banking and Insurance
State of New Jersey
Representing Zone I – Northeastern, NAIC